Supreme Court of the United States

OCTOBER TERM, 1947.

No. 405

In the Matter

of

REALTY ASSOCIATES SECURITIES CORPORATION,
Debtor.

MANUFACTURERS TRUST COMPANY, Indenture Trustee,
Petitioner,

vs.

REALTY ASSOCIATES SECURITIES CORPORATION
and CONSOLIDATED REALTY CORPORATION,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND SUPPORTING BRIEF FOR MANUFACTURERS TRUST COMPANY, AS INDENTURE TRUSTEE.

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NEWMAN & BISCO,
Attorneys for Petitioner.

THE COURT PRESS, N. Y. C.

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Respondents.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable, the Chief Justice and the Associated Justices of the Supreme Court of the United States:

Your petitioner, Manufacturers Trust Company, a corporation organized and existing under the Banking Law of the State of New York, with principal office at 55 Broad Street, City of New York, New York, prays that a writ of certiorari be issued to the United

States Circuit Court of Appeals for the Second Circuit to review a judgment of that Court entered in the above entitled matter on July 23, 1947 upon decision of Judge Thomas W. Swan concurred in by Judge Learned Hand [Judge Charles E. Clark dissenting in separate opinion], which reversed and modified so much of the order of the District Court of the United States for the Eastern District of New York dated August 5, 1946 as allowed 6% interest on the bondholders' claim against the solvent debtor from the maturity of their bonds and affirmed so much of said order as related to the application of an interim payment of interest, and respectfully shows and represents as follows:

Summary and Short Statement of the Matter Involved.

The facts of this matter are not in dispute.

In 1928 debtor, a corporation dealing in real estate, mortgages and securities, had outstanding three series of unsecured coupon bonds totalling $15,000,000 which carried 6% interest "until payment of the principal". Thus a major portion of its assets represented and continued to represent capital borrowed from some 2100 bondholders.

In a composition in bankruptcy dated as of July 10, 1933, the bonds were reduced by cash payment and modified and extended to October 1, 1943 by Supplemental Indenture with Manufacturers Trust Company, the Indenture Trustee, (hereinafter also referred to as the indenture). Coupons were detached and the bonds registered and stamped to indicate the modifications. Thereafter, interest at the rate

of 5% was payable currently from earnings. Unpaid interest was cumulative and payable with principal punctually at maturity or whenever principal might theretofore become due.*

Debtor's Profitable Operations in Its Bonds and Deliberate Default at Maturity.

In the ensuing ten year period debtor took advantage of a peculiar definition of "Earnings" (R 94-95) to pay interest at the rate of but 3%. It thus deferred payment of 2% interest which accumulated to $1,286,646.43 at maturity. This withholding, deferment and accumulation of interest enabled debtor to buy in bonds of a face value of $4,888,175, at depressed values, for but $2,178,044.13, with a consequent profit of about $2,700,000, and cancellation of

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* Pertinent Provisions of the 1933 Supplemental Indenture.

Debtor, instead of the 5% contract rate of interest "until payment of the principal", newly covenanted to pay interest "until the reduced principal on each such Bond shall be duly paid". Article III Section 1 (R 92) and newly promised to "duly and punctually pay the principal . . . together with interest . . . not theretofore paid, on October 1, 1943". Article IV Section 1 (R 99).

It agreed unconditionally that after October 1, 1943, any registered bondholder might sue in his own right to recover principal or interest. Article VI Section 8 (R 122) and Certificates of Modification as issued to bondholders (R 80). All other rights of action vested in the Trustee, whose several separate and distinct remedies provided in Article VI, Section 1, were conditional and not to be exercised in any instance without certain conditions precedent (R 117-118). Any sum so collected by such Trustee was to be applied to the whole amount then unpaid with interest at 5% on overdue principal only (R 119-20).

No declaration of default, no condition precedent and no collection by the Indenture Trustee has taken place herein.

those bonds would have shown a book value surplus of $2,500,000 (Appendices to Brief, pages b2-b7).*

Debtor, though possessed of assets exceeding $13,000,000, including cash of $1,250,000 and legals of a then market value of $1,760,069 (Appendices page b3), omitted provision for payment of the principal or unpaid accumulated interest due on its bonds at maturity.

Instead, on September 28, 1943, three days before the maturity date, debtor filed petition for reorganization under Chapter X listing no other debts save minor current bills (Appendices page b4).

As a Result of the Chapter X Proceeding Debtor's Estate Was Enriched by the Use of and the Vast Income from Moneys Withheld from Bondholders after Maturity.

The order approving the petition stayed bondholders as well as the Indenture Trustee from bringing suit at maturity and immediately reducing all claims to judgment bearing 6% in the State of New York. Thereafter and until April 15, 1945 debtor not only stood in default of the principal and accumulated interest due at maturity but also of any interest thereon, except such as was allowed by Court order.

At maturity on October 1, 1943, the publicly held bonds amounted to $5,710,400 on which unpaid interest at 2% per annum had accumulated to $1,286,646.43, as aforesaid. The total $6,997,046.43 constituted the admitted claim of bondholders.

Debtor's estate consisted mostly of mortgages, securities and interest-bearing or income-producing assets. But no part of the $1,286,646.43 in accumulated and

*Paragraph 5 of debtor's petition also shows that of $2,414,528.55 accumulated interest shown as a "Liability", $1,113,606.12 represented interest on the bonds so acquired (Appendices, page b5).

unpaid interest, and no interest thereon, was paid during the proceedings.* That sum as well as the vast income therefrom were profitably used in debtor's business throughout the proceedings. Debtor's financial position thus greatly improved during the Chapter X proceeding (R 144) and this aided debtor in finally borrowing and refunding through its sole stockholder, Consolidated Realty Corporation, a subsidiary of Reconstruction Finance Corporation.

Early in the proceedings the holders of an insignificant portion of the bonds (less than 1/5 of 1%) moved to dismiss the petition for lack of "good faith". The motion was denied and no appeal taken.

The Solvent Debtor Finally Refunded Through its Stockholder.

In March 1945 debtor and its stockholder by joint application sought leave to pay the bonds in full by said refunding, disclaiming liability as to any interest in excess of 5% on principal. In order to obtain immediate dismissal and release of the business and assets from court regulation and restrictions, they proposed a "Trustees' Reserve" to cover any additional amount of interest which might be allowed bondholders (R 13, 19, 22).

By Order entered April 2, 1945, the District Court dismissed the proceedings, provided for payment on April 15, 1945 of the principal amount of the bonds and interest thereon at the contract rate of 5% together with the unpaid accumulated interest due at

* Partial payments of current interest at the rate of 3%, as ordered from time to time during the proceedings, were based only on the face amount of the bonds, viz: $5,710,000. The only payments on the claim were two partial payments on account of principal totalling 35% thereof.

maturity. It also set up the reserve proposed by debtor and retained jurisdiction to determine [1] whether, after default at maturity, bondholders were entitled to interest at the contract rate of 5% or at the legal rate of 6%, and [2] whether interest should be paid on the $1,286,646.43 portion of the claim representing the ten year accumulation of unpaid interest which had become due at maturity (R 26, 33, 38).

Ruling of the District Court.

The District Court thereafter determined said questions in the affirmative, and petitioner here quotes, as apposite to matters hereinafter discussed, the following portions of its decision:

> "To adopt debtor's construction would require entirely reading out of the agreement the word 'duly'. (R 175)
>
> Article III. Section 1 is plain and unequivocal when read in conjunction with the particular covenant of Article IV. But even assuming *arguendo* that Article VI be deemed to create an ambiguity . . . such ambiguity would have to be resolved in favor of the bondholders . . . (R 176)
>
> To compound interest means to add to the principal at the end of each interest period the amount of the interest for that period so as repeatedly to broaden the base upon which future interest is computed . . . no interest is sought on installments of interest . . . (R 178)
>
> The bondholders' claim in the instant case is only for simple interest upon a debt which has become due and is therefore not contrary to public policy. (R 179)

> The admitted liability of the debtor thus constituted the equivalent of one claim for $6,997,046.43 . . . since the bonds were by their terms interest bearing, the interest which matured with the principal on October 1, 1943, constituted an equally integral part of the same claim.
>
> There is no basis for recognizing any distinction between these two parts of the claim." (R 180)

The order of August 5, 1946, allowed interest at the rate of 6% upon the whole of bondholders claim from October 1, 1943, the due date. Debtor and its stockholder appealed therefrom. As Indenture Trustee, petitioner appealed as to the application made in said order of the first interim interest payment and the computation of interest thereon (R 189-197).

THE DISSENT IN THE CIRCUIT COURT OF APPEALS.

The Circuit Court of Appeals, Second Circuit, by divided Court, reversed the District Court in respect to the interest questions and declined consideration of the interim interest issue as academic (R 211-218). The errors inherent in the judgment below sufficiently appear from the following portions of this petition and annexed Brief. The prevailing opinion conceded that debtor's assets seemed ample to pay bondholders at maturity, and Judge Clark, dissenting, succinctly stated the case as follows:

> "This is now a contest between a solvent debtor and its creditors over a direct obligation which has become fixed and final . . . It should not be affected by the abortive reorganization proceed-

> ings. . . . The situation is one therefore where a debtor who has availed himself of the bankruptcy provisions ultimately is able to pay in full; he should not then be permitted to make use of the statute to reduce his claim. Obviously here, except for the proceedings, the creditors would have taken judgment at once; they should not be deprived of that advantage by the debtor's unassented-to act (R 218).
>
> That this was a reorganization, rather than an ordinary bankruptcy, proceeding would seem not to change this situation. It is still only a question between the debtor and its creditors. The cases in railroad reorganization were cases involving equities between classes of creditors. The *Vanston* case, *supra,* 329 U. S. 156, 164, 165, is, I believe, important authority for this view . . . These views would mean that at least from the time of allowance, the claim, including the interest due thereon at the time, would bear interest at the legal rate of 6 per cent" (R 219).

The judgment of the Circuit Court of Appeals dated July 23, 1943, directed that the order of the District Court, which covered other matters, be modified (R 209-222). Petitioner seeks review of said judgment in all respects.

Jurisdiction.

Jurisdiction is invoked under Section 24, Subdivisions a and c, of the Bankruptcy Act (11 U. S. C. A. 47 a and c) and Section 240, Subdivision a, of the Judicial Code, as amended by Act of February 13, 1925 (28 U. S. C. A. 347a).

The Statute Involved.

The Statute involved is the Bankruptcy Act, Chapter X, Section 102 [providing for the application in Chapter X proceedings of other provisions of the Act relating to straight bankruptcy, which need not be set forth at length], and the following Sections:

> 106. For the purposes of this chapter, unless inconsistent with the context—(1) "claims" shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent;
>
> 114. Upon the approval of a petition, the jurisdiction, powers, and duties of the court and of its officers, where not inconsistent with the provisions of this chapter, shall be the same as in a bankruptcy proceeding upon adjudication.
>
> 115. Upon the approval of a petition, the court shall have and may, . . . exercise all the powers, not inconsistent with the provisions of this chapter, which a court of the United States would have if it had appointed a receiver in equity of the property of the debtor on the ground of insolvency or inability to meet its debts as they mature.
>
> 200. Where not inconsistent with the provisions of this chapter, the rights, duties, and liabilities of creditors and of all other persons with respect to the property of the debtor shall be the same, . . . upon the approval of the petition, as in a bankruptcy proceeding upon adjudication.

The Questions Presented.

1. Whether in a Chapter X proceeding as a matter of Federal law relating to distribution of assets:

a. the rights of creditors are any less than in straight bankruptcy or equity receivership proceedings, or do the same principles govern the allowance of interest?[1]

b. interest may be allowed on an allowed claim consisting of principal and accumulated accrued interest which became due at or about the time of the filing of the petition? And if so, what governs the rate of such interest?

c. the allowance of interest during the proceeding on bondholders' matured claim is in any manner dependent upon or controlled or limited by the local laws?

d. a solvent debtor obtains a moratorium without obligation to pay interest on allowed claims, unless provided for by contract?

e. interest can be denied on an entire claim where a solvent debtor has defaulted in payment of principal with interest due at maturity and failed to pay even the full contract rate due after maturity until more than eighteen months after maturity?

f. in determining allowance of interest in a voluntary proceeding by a solvent debtor having but

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[1] "A Chapter X Reorganization Court is just as much a court of equity as its statutory antecedents." (*Vanston Bondholders Pro. Com.* v. *Green*, 329 U. S. 156; *Johnson* v. *Norris*, 190 Fed. 459 C. C. A. 5th; *Ohio Savings Bank and Trust Co.* v. *Willys Corp. et al.*, 8 F. 2nd 463 C. C. A. 2d.)

one class of creditors [where the balance of equities is between debtor and its creditors], it is error (a) to apply the principles governing the allowance of interest upon claims in cases of insolvent debtors[2] [where the balance of equities is between creditor and creditor], or (b) to follow cases where the maturity dates of the obligations did not arrive until long after the filing of the petition[3]—in none of which does the precise question as to creditors right to legal interest against an estate able to pay it, appear to have been raised?

2. Whether the Circuit Court of Appeals has properly interpreted and applied the law of the State of New York insofar as same affects the rights of the debtor or its bondholders?

3. Whether the Circuit Court of Appeals properly balanced the equities between bondholders and the debtor?

4. To what extent and at what rate, interest is payable in respect of bondholders' claim.[4]

5. Whether the District Court in its order of August 5, 1946 made proper application or disposition of the partial interim interest payment of January 1, 1944?*

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[2] *Ecker* v. *Western Pacific R. R. Corp.*, 318 U. S. 448; *Brooks* v. *St. Louis-San Francisco Ry. Co.*, 153 F. 2d 312; *Chicago, Milwaukee, St. Paul & Pacific R. R. Co.*, Reorganization, 254 I. C. C. 707.

[3] *In re McKesson & Robbins, Inc.*, 8 S. E. C. 853.

[4] *National Bank of the Commonwealth of New York City* v. *Mechanics National Bank*, 94 U. S. 437; *In re John Osborn's Sons & Co.*, 177 Fed. 184, C. C. A. 2d; *Johnson* v. *Norris*, *supra*.

* To be determined in event bondholders are allowed 6% interest.

Reasons for Granting the Writ.

1. The Circuit Court of Appeals has rendered a decision on important Federal questions of far-reaching significance and general application in the administration and distribution of assets under the Bankruptcy Act, in obvious and direct conflict with the established equity and bankruptcy practice.

The decision below presents a novel application of Sections 102, 106, 114, 115 and 200 of the Bankruptcy Act particularly with respect to the treatment of matured claims against solvent debtors under Chapter X.

The questions and principles involved are of a recurrent nature and are of particularly broad and general application at the present time in reorganization cases, vitally affecting literally thousands of public investors.

Due to war and postwar conditions or inflationary trends many debtors are now found possessed of assets sufficient to warrant interest upon claims before the return of assets or of the business to the debtor for the benefit of stockholders.*

Illustrative of the questions raised by this petition are two recent Chapter X proceedings in the Southern District of New York in which provision for interest on matured claims composed in part of unpaid interest to the date of the reorganization petition was contained in reorganization plans which have been approved. (*In re Childs Co.*, S. D. N. Y. Bankruptcy

* Directly raised is the same "apparent restriction on the power of the Bankruptcy Court . . . in the exercise of its broad equitable powers" which prompted this Court to review *Pepper v. Litton*, 308 U. S. 295, 296.

The present issues are of the same basic importance.

No. 82868, November 27, 1946, opinion by Conger, *D. J.*, CCH Bankruptcy L. Serv. par. 55779; *In re United States Realty & Improvement Co.*, S. D. N. Y. Bankruptcy No. 83280, order dated May 14, 1946, par. 18.)*

The recent decision of this Court in *Vanston* v. *Green*, 329 U. S. 156, 67 S. Ct. 237 (1946) does not determine the questions raised in this application. There, this Court dealt basically with the question as to whether interest was payable on interest coupons which accrued during the pendency of the Chapter X proceeding. In this case the questions relate to allowance of interest on claims in Chapter X which are composed in part of interest accrued prior to the proceeding. The need for clarification of the law in the present situation is equally as compelling as in the *Vanston* case.

2. The issues are of immediate importance because they concern the adaptation and application of established Federal equity practice by Chapter X reorganization courts which have heretofore been held to be "as much courts of equity as their statutory and chancellory antecedents".**

3. The decision below is radical departure from the commonly accepted principles in bankruptcy

* In several proceedings under Section 77 of Chapter 8 of the Bankruptcy Act, like issues may affect the rights of creditors. *In re Florida East Coast Railway Co.;* No. 4827-J S. D. Fla.; *In re Georgia, Florida and Alabama Railroad Co.;* No. 89 M. D. Ga.

** It is not claimed that a solvent debtor may not seek the protection of Chapter X, but it is urged that creditors are not thereby deprived of rights which would be accorded them in any other Federal court of equity.

and reorganization, and is based upon a conception of the purposes and effect of Chapter X which runs counter to equity, bankruptcy and reorganization precedents and practice. It calls for an exercise of this Court's supervision.

The court below has set forth an entirely new doctrine, or body of law, as to the character, incidents and "divisibility" of claims in Chapter X, the effect of which is to award holders of matured claims against solvent debtors a lesser amount of interest during the reorganization proceeding than they would be entitled to were the proceedings in bankruptcy or in equity.*

These matters are of such importance as to require critical analysis and determination at highest level, because it is the first instance in which the statutory definition of a claim under Chapter X (Section 106), its divisibility and incidents has been squarely raised.

4. The decision below results in anomalies, administrative complexities and numerous deviations from the present practice under Chapter X as it relates to the rights of creditors in reorganization proceedings—all being of paramount importance in the bankruptcy and corporate reorganization fields. Certain of the more significant aspects are covered in the annexed Brief with such brevity as the extent and intricacies of the issues and derivative problems permit.

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* Herein also exist the same "contrarity of tendancies in practical administration" which impelled supervision by this Court in *Case* v. *Los Angeles Lumber Products Co.*, 303 U. S. 106, 109.

The Federal questions are of the same, and no less, significance as those brought up for review by this Court in *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 514 and *Prudence Realization Corporation* v. *Geist*, 316 U. S. 89, 92.

5. The Circuit Court of Appeals signally failed to follow the recognized state law, and its decision conflicts with applicable New York decisions, (a) in construing the Indenture of 1933 and (b) in other aspects of the case which the Circuit Court holds material to the issues and upon which it has placed much stress.

This decision is bound to prove misleading as to these important subjects not only for other tribunals but also for the State and Federal bar.

6. The prestige and respect enjoyed by the tribunal below and the volume of reorganization practice in the Second Circuit, *presently*, make certain the immediate spread of confusion in the practice there now obtaining—and, *prospectively*, is bound to lead to extensive conflict and divergent opinion with and between the other Circuits which have long followed the existent equity practice and will undoubtedly further disagree with the present ruling of the Second Circuit.

7. In simple justice, it is of transcendent importance that the wrong to this solvent debtor's many bondholders be rectified.

Importance of the Questions.

Certain of the more important aspects of the questions are patent from the questions stated at pages 10 and 11 hereof, while others are set forth in the Brief attached hereto and made part hereof.

Much attention has been drawn to the opinion of the Circuit Court of Appeals and a great deal of importance attached thereto by jurists and members of the Federal and Bankruptcy bars. The New York Law Journal, which does not publish the text of

Federal Court decisions except in rare cases of great importance, recently set forth on the front page the full text of the decision below. Your petitioner and its counsel have received a great many inquiries in respect thereto from attorneys, trustees, investors of all classes and others. The matter continues to be widely discussed and is of unquestioned public importance. Few decisions in recent years have been more broadly criticised or viewed as of such direct significance to distressed corporate creditors.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Court directed to the Circuit Court of Appeals for the Second Circuit, commanding that said Circuit Court of Appeals certify and send to this Court a full and complete transcript of the record of all proceedings of said Circuit Court of Appeals had in said cause to the end that same may be reviewed and determined by this Court as provided by law, and that this Court grant such other relief in these premises as may seem just and proper.

Dated: October 18, 1947.

MANUFACTURERS TRUST COMPANY, as
Indenture Trustee under Indenture dated as of July 10, 1933,
By FRANK P. GAGE,
Trust Officer.

PERRY A. HULL,
Counsel for Petitioner

NEWMAN & BISCO,
Attorneys for Petitioner

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

Opinions of the Courts Below.

The opinion of the United States District Court for the Eastern District of New York (Moscowitz, *J.*) appears at page 171 of the record.

The prevailing opinion of the Circuit Court of Appeals for the Second Circuit (per Swan, *J.*) appears at page 211 of the record and the dissenting opinion (by Clark, *J.*) at page 218 of the record.

Jurisdiction.

Jurisdiction is invoked under Section 24, Subdivisions a and c, of the Bankruptcy Act (11 U. S. C. A. 47 a and c) and Section 240, Subdivision a, of the Judicial Code, as amended by Act of February 13, 1925 (28 U. S. C. A. 347a).

Statement of Facts.

The facts material to the consideration of the petition are set forth at pages 2 to 6 thereof.

The Statutes Involved.

The statutes involved are Sections 102, 106, 114, 115 and 200 of the Bankruptcy Act.

Questions.

The questions presented are set forth in the petition on pages 10 and 11 hereof and covered at length in this Brief.

POINT I.

The decision below raises questions not heretofore considered by this Court which are of great importance because of their widespread application in corporate reorganization practice and because establishing precedent in conflict with the long recognized authorities and the present equity practice.

A.

Whether the Congress intended to deprive creditors in Chapter X of any rights which they would have had in straight bankruptcy or in equity receivership—and whether a claim in Chapter X is something less than a claim in straight bankruptcy and equity—are questions of grave import.

Was the Circuit Court of Appeals free to disregard the present practice in such matters—or has it violated the provisions of the above quoted Sections 102, 114, 115 and 200 of Chapter X which this Court appears to have made applicable in such matters of distribution (*Vanston Bondholders Pro. Com.* v. *Green*, 329 U. S. 156, footnote 8 thereof).

B.

No court has ever questioned when a debt becomes due and great significance must attach to the doctrine newly announced below, that in Chapter X a debtor's debt will not be due at maturity "but that they will be extended in whole or in part by means of substituted obligations" (R 214). This can be the case, if at all, only where a plan duly accepted by creditors specifically provides for such substituted obligations. It cannot be true in a case where, as

here, no substitute obligation was ever proposed or consented to, for even non-assenting creditors are given "adequate protection" by Section 216 (7), and Judge Clark, dissenting, justly observed:

> ". . . creditors would have taken judgment at once; they should not be deprived of that advantage by the debtors *unassented-to act.*"

C.

The Circuit Court states, for general application, that in Chapter X

> ". . . debts do not become due finally except to the extent and in the manner that the plan provides." (R 214)

and this actually suspends the maturity of every debt and bases the further holding that Chapter X affords a solvent debtor a "moratorium", during which it need pay no interest [except as specifically required by the New York law of contract] upon any debts due at the time of its petition.

This is novel, radical doctrine indeed. On it the Circuit below utterly rejects in Chapter X the so-called "judgment theory", a principle of long standing in Federal equity jurisprudence and first applied in bankruptcy by the same Circuit (*National Bank of the Commonwealth of the City of New York* v. *Mechanics National Bank*, 94 U. S. 437; *In re John Osborn's Sons & Co.*, 177 Fed. 184).

D.

Under all recognized authorities and for all practical purposes, the overdue interest merged with the overdue principal into a single indivisible claim on

October 1, 1943. (*Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510; *National Bank of Commonwealth of New York City* v. *Mechanics National Bank, supra; Adams* v. *Napa Catine Wineries*, 94 F. (2) 694; *United States* v. *Peerless W. V. M. Corp.*, 96 F. (2) 996, certiorari denied.) *Ferguson* v. *Lyle* (267 Fed. 817, 819, C. C. A. 5th) holds

> ". . . creditors are entitled to interest owing at the time of the filing of the petition. The case is therefore reversed . . . with directions to allow the whole of the claim of appellants. . . ."

No justification exists for (1) splitting a "claim" as to principal and interest and then (2) treating each portion separately in determining allowance of interest, as was done in this case (R 217).

If a debtor has several creditors, to some of whom only interest is due at the time of the petition, would the claims for such interest be singled out and distinguished from all other claims as not equitably entitled to interest? That is the effect of the ruling below (R 180, fol. 539-540).

Most corporate debtors have large interest obligations maturing about the time of their petitions, and the rule stated below upsets the present practice in these matters in almost every case.

The present practice has not varied over the years while the allowance of interest, assets permitting, is a matter of common occurrence. Yet to this date no limitation has been placed upon the definition of "claim" in Section 106 of Chapter X. The practice herein provided deserves proper elucidation of important principles for general application, for example: is interest due at the time of the petition a "claim" under Chapter X?—if so, is such claim

separate and distinct from a claim for principal maturing on the same date under the same contract?—and what is comprised in the base of an allowed "claim" upon which interest may be computed?

In straight bankruptcy, under Section 63, a matured "claim" for principal and accrued interest would not be divisible for any purpose, *i. e.*, for allowance of interest, voting, etc.

E.

No Circuit Court has heretofore rejected the judgment theory and the Circuit below has seen fit to explain

> ". . . we are not convinced that the 'judgment theory' is applicable in a Chapter X reorganization, where the very purpose of the proceeding is to keep the debts in *statu quo* until a plan can be adopted under which the debtor may continue in business without having its property burdened with judgments" (R 214).

The fact is, the judgment theory establishes and stabilizes the character, amount and incidents of each obligation of a debtor as of a given date and so maintains the "*statu quo*",[1] and the dissenting Judge properly correctly stated:

> "As the opinion substantially concedes, allowance of a claim in bankruptcy fixes it, just as does a judgment. . . ."

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[1] *Bank of the Commonwealth of the City of New York* v. *Mechanics National Bank, supra; In re John Osborn's Sons & Co., supra.*

Furthermore, the judgment theory can no more "burden the property of the debtor" than can the equity rule for interest where assets permit.[2]

More occasion actually appears for invoking the judgment theory in Chapter X [whenever the question is directly raised on behalf of creditors, as here, and not waived by plan] in which the whole going business is returned to the ~~creditor~~ debtor and stockholders, both of whom are thereby benefited, than there would be in cases of bankruptcy, equity or statutory liquidation proceedings in which the business and all assets are eventually liquidated and utterly lost, to the detriment of the debtor and the stockholders.

The Circuit Court has used broad sweeping language which, if allowed to stand, is certain to lead to much confusion for it upsets the long established practice in Federal and State equity courts where interest is allowed on the whole debt, assets being sufficient.[3] Its specious reasoning should be reviewed and disclaimed.

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[2] *Johnson* v. *Norris*, 190 Fed. 459, C. C. A. 5.

[3] *In re Childs Co.*, S. D. N. Y. #82868, Nov. 27, 1946, opinion by Conger, *D. J.*, C. C. H. Bankruptcy, Bk. Cy. L. Serv. Par. 55779; S. E. C. Corp. Reorg. Release #67 and #69, C. C. H. Bankruptcy Bk. Cy. L. Serv. Par. 55734 and 55778; *In re United States Realty & Improvement Co.*, S. D. N. Y. #83280, order dated May 14, 1946; *In re Town*, Fed. Case #14112, E. D. Mich. 1873; *In re Bank of North Carolina*, Fed. Case #895 W. D. N. C. 1875; *In re Hagan*, Fed. Case #5898, S. D. N. Y. 1873; *Richmond* v. *Irons*, 121 U. S. 27; *People* v. *Merchants Trust Co.*, 187 N. Y. 293, 297-9; *People ex rel. Immigrant Industrial Savings Bank*, 284 N. Y. 57, 1940; *People* v. *American Loan & Trust Co.*, 172 N. Y. 371; *Lippitt* v. *Thames Loan & Trust Co.*, 88 Conn. 185, 206-7; *Central Bank & Trust Co.* v. *State of Ga.*, 139 Ga. 54, 56, 58; *Elliot* v. *First National Bank of Pendleton*, 32 F. Supp. 839; *Stein* v. *Delano*, 35 F. Supp. 260, affd. 121 F. (2d) 975 (C. C. A. 3rd). See also 3 *Michie Banks and Banking*.

F.

In particular this is the only time a Circuit Court has failed to apply, where the facts are squarely analogous, the long established equity principles for allowance of interest laid down in *Johnson* v. *Norris, supra,* recently again cited with approval by this Court.

G.

The Circuit Court of Appeals in effect holds that the claim on the simple debt for interest, which did not carry contract interest, must be denied interest in Chapter X. It makes that purpose unequivocally clear when it distinguishes its own prior ruling (*In re John Osborn's Sons & Co., supra*) on the ground that "in that case the bankrupt made no contract providing for payment of interest", showing it would deny interest on the claim for accrued interest as well as on the claim for principal.

Does Chapter X grant a "moratorium" during which a debtor can escape all interest except that provided by contract held to be valid under the State law?

The rule laid down below offers opportunity and invitation to unscrupulous debtors to engage in abortive reorganization proceedings under Chapter X for the purpose of avoiding, throughout the proceeding, all interest on matured and defaulted debts, except that previously stipulated by contract; it would encourage debtors to prolong such proceedings for like purpose; it proposes that any creditors holding debtor's promise for interest after maturity would be bettered and privileged over other creditors

to the extent of such interest; it creates a practice prejudicial and unjust to creditors and is bound to lead to widespread abuse; and it is demoralizing to both debtor and creditor alike.

It is of transcendent importance that this unconscionable practice be stopped before it assumes alarming proportions.*

H.

It is of great moment that a court of equity has sanctioned profit by a solvent debtor at the expense of creditors powerless to resist a proceeding where a large part of the sums due at the time of the petition (over $1,280,000) were withheld without any interest whatever though profitably used in enriching debtor's estate.

This does violence to all of the principles long recognized in the Federal and State authorities above cited, *Johnson* v. *Norris, supra,* being exact in point of fact and apposite in point of equitable rationale and doctrine. *Sexton* v. *Dreyfus* (219 U. S. 339, 346) holds

> "There is no more reason for allowing the bankrupt estate to profit by the delay beyond the date

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* Specifically, debtor defaulted at maturity as well as in timely payment of the contract rate of interest claimed by debtor to be due on principal after maturity. Having received the vast income and profits from such moneys throughout the proceedings, it belatedly tendered with the debt only contract interest on principal when refunding through its stockholder 18 months later.

In the absence of contract for interest after maturity, stockholders would have succeeded to all and entire the income from moneys which were detained from bondholders during the statutory stay in Chapter X.

Can such practice spring from Chapter X?

of settlement than there is for letting creditors do so."

That rule and other equitable rules as to distribution of assets and allowance of interest by Federal Courts and in bankruptcy is made applicable herein by Section 115, which Section has been held by this Court to be applicable in such matters (*Vanston Bondholders Pro. Com.* v. *Green, supra*).

That creditors of any class should suffer for the benefit of a solvent debtor and its stockholders in a court of equity is unthinkable.

I.

Present practice[4] is further disturbed by the fact that the Circuit Court of Appeals, in determining both the practice as to allowance and rate of interest, has applied authorities pertaining to Federal distribution of assets in cases of insolvency—*where the balance of equities is between creditor and creditor.* The dissenting opinion makes clear that the authorities relied upon in the prevailing opinion are inapposite, stating:

> "This is now a contest between a solvent debtor and its creditors . . . The cases in railroad reorganization are cases involving the equities between classes of creditors" (R 218, 219).

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[4] Per authorities in footnotes 1, 2 and 3 above.

J.*

Any unsuccessful motion to dismiss a debtor's petition for lack of "good faith" is entirely foreign to the equitable allowance of interest unless, conceivably, shown to prejudice debtor, *a circumstance not here presented*. Even the debtor did not argue or claim prejudice or that the motion to dismiss for lack of good faith in any way affected bondholders' right to interest. Nevertheless, the ruling below establishes a dangerous precedent in that respect (R 215-217) for the Circuit Court of Appeals then goes on to hold it "most inequitable for creditors who so long acquiesced in the pendency of the proceeding, now to say that all the time it was nothing but a bad faith moratorium to keep them out of their money" (R 217).

The motion as to "good faith" of the petition did not in any manner delay the proceedings and thereafter creditors had no alternative but to "acquiesce". Even had they appealed, as the Circuit below suggests, would they still be deprived of interest simply because they were powerless to dismiss a statutory proceeding? See *Johnson* v. *Norris*, *supra*, as quoted in Point II hereof.

The decision effectually places Danceles' sword over the head of *all* creditors in event any one of their num-

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* It is a matter of most serious consequence that the Circuit Court of Appeals so far misapprehended the issues, as to state that "bondholders contend the petition was not filed in good faith" and to thus misrepresent bondholders' position in the present issue as a motion to dismiss made by an insignificant portion of bondholders—less than 1/5 of 1% in amount.

The facts surrounding the petition (such as debtor's solvency, its failure to make timely provisions for payment of bond at maturity, etc.) were pointed out as factors to be weighed in balancing the equities between a solvent debtor and its creditors (*Johnson* v. *Norris*, *supra*) but those factors were entirely misapprehended and disregarded.

The good faith of the petition, as such, is not here at issue and is not challenged. The interest questions were reserved at the debtor's instance, and no such issue was even raised by it.

ber unsuccessfully moves to dismiss a petition for lack of good faith. It discourages resort to that statutory right of every creditor in Chapter X.

Evils bound to result from the ruling herein are difficult to estimate and the iniquitous over-all results are sure to approach sociological as well as juridical proportions.

K.

The "bargain" conceived of below does not even exist under New York law (see Point III) and this basic error will stand as a misleading precedent to all lower courts and other or distant Circuits. Review is specially urged to obviate further misconception of and divergence from, the local law (R 217).

Even if the "bargain" be valid under state law, does that mean the reorganization court is bound thereby in allowing interest under its broad equitable powers? In other words, what are the factors that must be weighed in balancing the equities between a debtor and its creditors? See heading "L" of this Point.*

L.

This is the first case to hold that a "bargain" [a pre-existent contract limiting the rate at which and the base upon which interest is to be computed on principal after maturity], because held to be valid under the State law, has been held to outweigh and override all other equities between a solvent debtor and its creditors. In reaching that conclusion the Circuit Court stated (R 215-217):

> "Conceivably Chapter X may permit a debtor to hold off its creditors, even though it has sufficient assets to pay them, merely because its business

* The Court below saw fit to work errors (J and K) into one argument, but this cannot confuse the very apparent issues.

> will suffer disproportionately if it is compelled to make such sacrifice (See *In re Loeb Apartments*, 89 F. (2) 461, C. C. A. 7)."[5]

It is not questioned that a solvent debtor may petition in Chapter X—but this petitioner maintains that creditors are not thereby deprived of rights which would be accorded them in any other Federal court of equity or bankruptcy.

M.

Not heretofore determined by this Court are two questions of outstanding importance in the Federal administration of assets, viz. Where the balance of equities is between creditors and debtor, is the allowance of interest on a claim which matured at the time of the petition in any manner dependent upon or limited or controlled (a) by the State law, or (b) by the terms of a contract, held to be valid under State law, as to the payment of interest after maturity, but which for 18 months thereafter stood breached in all respects?

The significance of these two questions in their application to the case at bar and other cases becomes apparent from the declared principles of this Court[6] that, assuming *arguendo* a contract to pay interest on coupons is valid under State law, such contract is nevertheless subordinate to the paramount question of whether the allowance of such interest, under the circumstances of the case, "would be compatible with

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[5] That case was also inapposite because "more than 66⅔% of the creditors had consented to the adoption of the plan . . . offered not by debtor but by creditors".

[6] *Vanston Bondholders Pro. Com.* v. *Green*, *supra*.

the policy of the Bankruptcy Act" to do equity between creditors and creditors of different classes.[7]

Let us, therefore, assume *arguendo* an agreement valid under State law to pay less than the legal rate of interest only on principal after maturity. **Will such agreement be subordinated to the paramount question of whether, in the circumstances of this case, the allowance of only such lesser interest would be "compatible with the policy of the Bankruptcy Act" to do equity between the solvent debtor and its creditors?**

Petitioner urges (1) that the Federal Court *alone* has jurisdiction and power to say "how and in what cases interest shall be allowed under equitable principals" and (2) that a solvent debtor should be equitably estopped or barred [except where it shows prejudice resulting from some act of the creditor] from asserting an agreement, held to be valid under State law, so as to deny creditors right to the legal rate of interest on the face amount of any claim due at the time of the petition during the period that the moneys withheld from them by statutory stay were being profitably used in debtor's estate. (*Dietrich* v. *Greaney*, 309 U. S. 190, 196; *Johnson* v. *Norris, supra.*)

* * * *

The issues pointed out above, and those apparent from the questions stated above, are of such importance and practical widespread application in the corporate reorganization field as to warrant review by this Court.

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[7] This Court, for the same reasons, similarly subordinated a contract, valid under State law, for interest upon coupons although the security therefore was admittedly adequate and notwithstanding the fact that the underlying mortgage was superior to all other liens and as such was not involved in the reorganization proceedings wherein the distributions of interest were to be made. *Fleming* v. *Traphagen, et al.*, 64 Sup. Ct. Rep. 365.

POINT II.

The decision below is in basic conflict with the long recognized principles of equitable jurisprudence as enunciated by this Court and by the several Circuit Courts of Appeal in matters affecting the Federal administration of property in *custodia legis*.

Much of the conflict between the decision below and the other tribunals appears from Point I above, and our purpose herein is to briefly point up important aspects of these numerous conflicts in the light of the problem at bar and related issues which seem certain to arise in the wake of the decision below.

As to the Conflict with the Fifth Circuit.

In *Johnson* v. *Norris*, 190 Fed. 459 (1911), the Fifth Circuit in a learned treatise, long recognized as authority, allowed interest on claims in bankruptcy, which claims included "interest to the date of filing the petition" (p. 461). The problem there considered exactly parallels the present one in all material, determinant respects,* to wit:

> "Can it be that the Act means that a voluntary petitioner may, although solvent in fact, stop the interest on his debts, while collecting by the trustee the interest on his assets; . . . in an *ex parte*

* Having in the main interest bearing and income producing assets, the solvent debtor herein, during the 18 months of this proceeding received and retained the vast earnings not only from the $5,710,400 unpaid face amount of the bonds (on which it seeks to pay but 5% interest) but also the very great income upon the $1,286,646.43 lump-sum accumulations of interest on which it seeks to pay no interest whatever.

proceeding which his creditors are not heard to resist?

In such case, if the contention of the respondents is to prevail, the proceedings may be greatly to the profit of the bankrupt after paying the referee and trustees the fees allowed by law.

The extraordinary result would be that a delay in payment arising from a proceeding begun by the debtor, and which the creditors were powerless to resist, would prevent the creditors from collecting interest out of an estate able to pay it, when the general rule is that interest is always given for delay in payment.

The bankrupt's estate often, as in this case, may consist, in the main, of interest bearing assets.

Where the settlement is delayed, this interest may amount to a large sum.

A construction of the act that would give it to the bankrupt, and leave unpaid interest on debts due from the bankrupt would seem strangely inequitable. . . . the litigation was begun by the debtor, and no proceeding was had at the instance of others to delay payment.

When the bankrupts . . . move the court to direct the fund to be paid to them, they should be required to do equity by paying the interest due by law up to date" (p. 463).

That case differs from the case at bar only in the respect that it was a proceeding in Bankruptcy. Under Sections 114 and 200, the jurisdiction, powers and duties of the Court as well as the rights, duties

and liabilities of creditors and of all other persons in respect to the property of the debtor would be the same in Chapter X, unless inconsistent therewith. The *Vanston* case (*supra*) indicates that such inconsistency does not exist. See footnote 8 of the Opinion of the Court therein.

Further conflict with the Fifth Circuit, as to the status of interest as an essential component of the base of a "claim", is to be found in the decision in *Ferguson* v. *Lyle*, 267 Fed. 817, 819 (1920) hereinabove quoted in Point I.

As to Conflict with the Third Circuit.

In *Bindseil* v. *Liberty Trust Co.*, 248 Fed. 112 (1917) the Third Circuit, interpreting creditors' statutory rights under the Bankruptcy Act, set forth the principles controlling in Federal statutory administration as follows:

> "In enforcing creditors' rights in the new way, it appears to us that equity should protect them in the same measure and preserve to them the same advantages, so far as practicable, that the law gave them before bankruptcy stepped in and interfered with them . . .
>
> As we are dealing in this case with the equitable administration of bankrupt assets, *where creditors' legal rights are preserved but where their legal remedies are lost* and equitable remedies are substituted, equity requires that the new remedies be as effective as the old in protecting and enforcing such rights." (Italics supplied.)

Here, the Circuit below has propounded entirely new doctrine whereunder the "new remedies" afforded by the statute are not as effective as the old in protecting and enforcing creditors' rights. It is in such radical conflict with the above quoted principles as to actually deprive creditors of the lawful right of suing upon their claims without, however, substituting any "effective" equitable equivalent.

Also, the Third Circuit, in a statutory liquidation in *Stein* v. *Delano,* 35 F. Supp. 260, affd. 121 F. (2) 975, cert. den. 314 U. S. 655, held:

> "The value of each claim at the time of the declaration of insolvency is the principal sum due . . ."

and the Circuit Court of Appeals in affirming said judgment stated:

> "The New Jersey National Bank and Trust Company did not profit to any ascertainable amount by becoming insolvent and failed to pay its debtors. It is being assessed interest *for the damage it did its creditors* rather than for any profit it obtained from the failure to honor its debts."

and the conflict with that principle is made obvious by the fact that here a very sizable profit (R 144) accrued to the debtor by reason of the fact that impressive sums due to creditors at the date of the petition were profitably kept in its business during the proceeding.

As to Conflict with Decisions of This Court.

A. As to the Allowance of Interest on Equitable Principles.

This Court stated in *Vanston Bondholders Pro. Com.* v. *Green* (329 U. S. 156), which also cited with approval *Johnson* v. *Norris*, as follows:

> "But where an estate is ample to pay all creditors and pay interest even after the petition was filed equitable considerations were invoked to permit this additional interest to go to the secured creditor rather than to the debtor.
>
> "It is manifest that the touchstone on each decision on the allowance of interest in bankruptcy and receivership has been a balance of equities between creditor and creditor or creditor and debtor."
>
> ". . . In either event first mortgage bondholders would have been enriched and subordinate creditors would have suffered a corresponding loss, because of a failure to pay when payment had been prohibited by a Court order for the benefit of debtor, creditor and the public. Such a result is not consistent with equitable principles . . .".

Emphasis is thereby placed upon the contrary and conflicting rule herein below announced, wherein a solvent creditor is allowed to escape the payment of any interest except as required by pre-existent agreement. If, therefore, in the words of this Court we

interpolate the facts of the case at bar it would result in substantially the following:

> **"Where an estate is ample to pay all creditors and pay interest . . . the ~~creditor~~ debtor has been enriched and bondholders have suffered a corresponding loss, because of a failure to pay when payment had been prohibited by a Court order which is as much if not more for the benefit of the debtor and the stockholder in preserving their equities as for creditors and the public".**

B. As to the Conflict with the Very Apparent Intent of the Statute.

This Court in the *Vanston* case, *supra,* indicated that such Section 115 of Chapter X is applicable in a matter involving the balancing of equities between creditor and creditor.

For what appears as a very inadequate reason, the Court below in effect holds to the contrary. The only apparent reason for its conclusion seems to rest in the fact that the Chapter X stay aided creditors as much as debtor—in other words that there exists an exception in this case where equities are balanced between the debtor and its creditors.*

This raises the question whether Sections 114, 115 and 200 of Chapter X have been violated by the decision below.

It would seem adequately clear that even under ancient authority (*Sexton* v. *Dreyfus,* 219 U. S. 339; *Bromley* v. *Goodere,* 1. Atkyns, 75), and under either

* If any such very important conflict or inconsistency does exist, it deserves immediate clarification by this Court on terms which will rationally and justly reconcile same with the existent law and practice.

the judgment theory or on equitable principles, the fact that the equities are to be balanced between a creditor and its debtor does not give rise to a situation so inconsistent with any purpose or provision of Chapter X as to read an exception into said Sections. Hence, the decision herein is patent conflict with the apparent reasonable Congressional intent underlying said sections.

Further, the definition of "claims" in Chapter X, Section 106(1) does not recognize any difference in the source of a "claim" or any basis for dividing an obligation arising out of a single contract for payment on a given date. The treatment accorded the claim below therefore is also a direct conflict with Sections 102 and 106(1) of Chapter X.

As to Conflict with the Judgment Theory.

On the same broad equitable principles, but with more significant clarification, this Court allowed interest upon claims for interest in the liquidation of a national bank on the grounds that in equity a claim has the same efficacy and occupies the same legal ground as a judgment. The rationale of *National Bank of the Commonwealth of the City of New York* v. *Mechanics National Bank* (94 U. S. 437) is particularly applicable in the present discussion. There interest was allowed [1] upon interest which had accrued between September 24, 1873, and November 22, 1873, on which latter date the receivership started, as well as [2] upon interest accruing from said latter date to November 20, 1874, when the last installment of principal was paid, this Court stating:

> "Two errors were assigned: (1) That the plaintiff below was not entitled to recover any interest.

(2) If interest was recoverable, as demanded, the plaintiff was not entitled to *interest on the gross amount of such interest* from the time when the last installments of the principal were paid . . .*

If these claims had been put in judgment . . . the result as to interest upon the judgment would have been the same . . . After they were proved, they were of the same efficacy as judgments, and occupied the legal ground . . . They are within the equity, if not the letter of these statutes, and bear interest as judgments.

The interest lawfully accruing upon each of the claims was as much a part of it as the original debt. The creditor had the same right to the payment of the one as the other . . .

If . . . the suit had been for the balance, consisting of interest only, the same result would have followed . . .

The plaintiff . . . is entitled *ex aequo et bono*, to the money sought to be recovered. Where the right to recover exists in this class of cases, it includes interest as well as principal, unless there is something which would render the payment of the former inequitable . . .

. . . See also *Robinson* v. *Bland*, 2 Burr. 1087. In the latter case Lord Mansfield said: 'The interest is an accessory to the principal and the plaintiff cannot bring a new action for any interest grown due between the commencement of his action and the judgment in it . . . I don't know of any court in any country . . . which does not carry interest down to the last act by which the sum is liquidated.' "

* Italics supplied.

The doctrine thus enunciated has been widely accepted and adopted in equity jurisprudence[1] and even the Circuit Court of Appeals below adapted and applied the same principles to claims under the Bankruptcy Act in *Re John Osborn's Sons* (177 F. 184, C. C. A. 2d) as follows:

> "We think that allowed claims in bankruptcy are as such entitled to be treated as judgments . . .
>
> Following the case of *National Bank of the Commonwealth of New York City* v. *Mechanics National Bank, supra,* the order is affirmed."

The New York Court of Appeals has recognized the status of allowed bankruptcy claims as "judgments" (*American Woolen Co.* v. *Samuelsohn,* 226 N. Y. 61, 70) and the courts of that state have enunciated similar principles (*Dorland* v. *Fidelity Deposit Corp.,* 104 Misc. 97; *Hunting* v. *Blun,* 143 N. Y. 511; *Lang* v. *Lutz,* 180 N. Y. 254, 260; *People* v. *Merchants Trust Co.,* 187 N. Y. 293; *Skilton* v. *Codington,* 185 N. Y. 80, 87).

As to Conflict with This and with Other Federal and State Courts in Respect to the Basic Principles That, Where Assets Permit, Equitable Considerations Are Always Invoked for the Payment of Interest upon Claims at the Legal Rate from the Date That Equity Intervened.

The very reasons given by the Circuit Court of Appeals for rejecting the judgment theory and so disallowing interest—viz: an act of law, or moratorium, designed for conservation of assets as much

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[1] See: 3 *Michie Banks and Banking,* Perm. Ed. 499; *Stein* v. *Delano,* 35 F. Supp. 260, D. N. J. 1940, aff'd. 121 F. 2nd 975, C. C. A. 3rd, 1941, cert. den. 314 U. S. 655, 1941; *Elliott* v. *First Inland National Bank* v. *Pendelton,* 32 F. Supp. 839, D. Oreg. 1940; *State ex rel. McConnell* v. *Park Bank & Trust Co.,* 151 Tenn. 195, 208; *People* v. *Farmers State Bank,* 371 Ill. 222, 224, 1938.

for the protection of creditors as of the debtor—have been carefully weighed and discarded by practically all of the authorities.

In the *Vanston* case, *supra*, as in practically all of the earlier Federal and State authorities,[2] it has been pointed out that

> "Exaction of interest, where the power of a debtor to pay even his contractual obligations is suspended by law, has been prohibited because it was considered in the nature of a penalty imposed because of delay in prompt payment—a delay necessitated by law if the courts are properly to preserve and protect the estate for the benefit of all interest involved."

Nevertheless, in all of the other authorities, as in said case, the conclusion is reached, on one ground or another, that

> "Where an estate is ample to pay all creditors and pay interest even after the petition was filed, equitable considerations were invoked to permit the payment of this additional interest . . ."

The decision below offers no new reasons, *i. e.*, none that have not already been considered by the authorities, for making a distinction in Chapter X proceedings, and is, therefore, in basic conflict with all such authorities.

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[2] *Johnson* v. *Norris*, 190 Fed. 459 (C. C. A. 5th); *In re John Osborn's Son*, 177 Fed. 184 (C. C. A. 2); *National Bank of the Commonwealth of the City of New York* v. *The Mechanics National Bank*, 94 U. S. 437; *Sexton* v. *Dreyfus*, 219 U. S. 339; *People* v. *Merchants Trust*, 178 N. Y. 293; *People* v. *American Loan & Trust*, 172 N. Y. 371; *Ohio Savings Trust Co.* v. *Willys Corp.*, 8 Fed. 2. 463 C. C. A. (2d); *Richmond* v. *Irons*, 121 U. S. 27.

In *American Iron & Steel Manufacturing Co.* v. *Seaboard Air Line Railroad* (233 U. S. 261), it is stated:

> "Even in bankruptcy, *and in the face of the argument that the debtor's liability on the debt and its incidents terminated at the date of adjudication*, and as fixed liability was transferred to the fund, it has been held, in the rare instances where the assets ultimately proved sufficient for the purpose, that creditors were entitled to the interest accruing after adjudication."

While it is not here questioned that a solvent debtor "may seek relief under Chapter X simply because its business will suffer disproportionately if it is compelled to make the sacrifice" (R 216)—this does not necessarily imply that creditors are to sacrifice interest in order to enable a solvent debtor to avoid sacrifice on its part.

To permit the debtor an opportunity to avoid sacrifices which its stockholders would otherwise suffer, should in equity warrant compensation to those who are actually harmed thereby.*

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* If a claim be one upon which judgment could not have been obtained had there been no stay in Chapter X, there would be no occasion to accord the creditor judgment rights or legal interest on his claim.

If a claim does not mature during the proceeding, the creditor is relegated to the contract rate, throughout the proceeding.

If the claim matures at or about the filing of the petition, the equitable principles of long standing require interest from maturity, the contract rate prevailing prior thereto. By "maturity" is meant normal maturity, not accelerated maturity.

This makes clear that we do not urge that judgment interest be allowed as a penalty for the institution of the Chapter X proceedings, as the decision below might lead one to believe (R 215-217).

The Court below, itself, long ago in *Ohio Savings Bank and Trust Company* v. *Willys Corporation*, 8 F. (2) 463 (1925), recognized that in equity:

> "It is true, however, that as a general rule, after property of an insolvent is in *custodia legis*, interest thereafter accruing is not allowed on debts . . . The reason assigned is that in such cases the delay in distribution is held to be the act of the law and a necessary incident to the settlement of the estate. . . . The rule does not prevent the running of interest during a receivership, and if, as a result of good fortune or good management, the estate proves sufficient to discharge the claims in full, interest as well as principal is to be paid . . ."

This Court in *Royal Indemnity Co.* v. *United States*, 313 U. S. 289, dealt with the historical background for the allowance of interest "for non-payment of the amount found to be due" and, though the case was a suit at law, this Court considered the fault for the delay the fair measure of damages involved, stating:

> ". . . Here responsibility for delay in payment rests quite as much upon the debtor, who is chargeable with knowledge of its own obligation and the breach of it, as upon the creditor. And *in the meantime, the debtor has had the use of the money, of which its default has deprived the creditor*. . . . Interest upon the principal sum from the date of default, at a fair rate, is therefore an appropriate measure of damage for the delay in payment . . ."

Again in *Richmond* v. *Irons*, 112 U. S. 27, in a liquidation proceeding involving book accounts of depositors which included interest, the Court said:

> ". . . In the case of book accounts in favor of deposits, which was the nature of the claims in this case interest would begin to accrue as against the bank from the date of its suspension. . . . and it follows that interest should be computed upon the amounts then due as against the shareholders to the time of payment."

In direct conflict with all known authority, the judgment below establishes the principle that the *solvency is not an equity to be "balanced" in determining whether interest is to be allowed upon the allowed claims of a debtor.* In this case the ruling has the further effect of turning the back of the Chancellor upon the fact that the debtor could have liquidated sufficient assets to pay its debts rather than to resort to an abortive Chapter X proceeding. This means that, in all cases of solvent debtors possessed of assets seemingly sufficient to meet its obligations at the time of the Chapter X petition, that fact could not be weighed in balancing the equities between such debtor and its creditors. It is an inequitable doctrine of far-reaching import in all reorganizations. It is a temptation to any debtors inclined to inequitable means for thwarting the legitimate ends of unoffending creditors. The basic conflict is patent.

* * * *

The aforementioned conflicts with all other authority are such as to call for the exercise of this Court's power of review in these premises.

POINT III.

The Circuit Court has decided important questions of local law in a way obviously conflicting with the settled law of New York.

a.

The Supplemental Indenture of 1933 materially modified the terms of the prior indentures. It added to debtors promised to pay at maturity the words "duly" and "punctually" (contract R 42 with R 92 and 99). It also added the provision granting individual bondholders the right of suit upon default in such payment (R 122, fol. 366). The provision that collections by the Indenture Trustee, under its conditional remedies, should be applied with interest at 5% on past due principal was a carry over from the 6% rate in the prior indentures (contract R 49 and 120).

Under the local law the new additions and agreements were controlling and took precedence over any prior engagements of the parties.[1] The Court below has violated this basic principle.

b.

The undisguised effect of the judgment below is to except, and read out of the indenture, the words "duly" and "punctually" as added in 1933—it affords no meaning to those words whatever (R 213). Such

[1] New York has always recognized that new or different words or provisions when added or used in modification of a prior contract, are controlling over the words and provisions of such contract. *Wynkoop H. C. Co.* v. *Western Union Tel. Co.*, 268 N. Y. 108; *Scruggs* v. *Cotterill*, 67 App. Div. 583; *Hart* v. *Lauman*, 29 Barb. 410, 416. See also opinion of the District Court (R 174-175).

an interpretation and construction is not permitted under the local law. It diametrically opposes the New York rule.[2]

c.

The Circuit Court based its determination of bondholders' contract rights on inapplicable authorities wherein the contract rate of interest was payable "until principal shall be paid" or "to the date of payment of the amount", however long that might be after the due date (212).[3]

The cases relied upon by the Court below have been carefully limited by the New York decisions to contracts involving the precise terms quoted or those clearly indicating similar intent.

The principles of those cases have not been extended beyond the particular covenants there involved—not one of them involve a contract involving the words "due", "duly" or "punctually".

In New York, both *Taylor* v. *Wing* and *O'Brien* v. *Young*, have been distinguished and declared inapposite in construing an agreement like the present indenture, where the specific and particularizing words "duly" and "punctually" may not be excepted, but must be deemed to denote a promise of punctual pay-

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[2] "A contract containing a term inconsistent with a term of an earlier contract between the parties is interpreted as including an agreement to rescind the inconsistent term in the earlier contract." (2 Restatement of the Law of Contract, Sec. 408.) See also opinion of the District Court (R 175, fol. 524).

[3] *Taylor* v. *Wing*, 84 N. Y. 471; *O'Brien* v. *Young*, 96 N. Y. 428; *Agency of Canadian Car. & F. Co.* v. *American Can Co.*, 258 F. 363, which the District Court had properly analyzed and distinguished (R 174-175).

ment on the due date, for as stated in *Ferris, et al.* v. *Hard,* 135 N. Y. 354,

> "This is not like the agreement to pay interest . . . until the principal sum is paid, such as the case of *Taylor* v. *Wing* . . . the whole principal sum of ten thousand dollars was to be at an interest of seven per cent . . . *until due* . . . If . . . not paid *when due,* the contract was violated, and interest after that . . . could only be recovered as damages and at the rate of interest authorized by law (*Bennett* v. *Bates,* 94 N. Y. 354; *O'Brien* v. *Young,* 95 id. 428)."*

d.

The decision below reads right out of the indenture, Article VI, Section 8 which grants individual bondholders the right of suit at maturity, a right theretofore reserved only to the Trustee. This new right was not in any sense "inconsistent" with the rights of the Trustee. It does not "cripple" the Trustee nor does it prevent the Trustee from adequately asserting bondholders' claims. To so construe the indenture, not only deprives them of this new and all important additional right or innovation, as added for their sole benefit in 1933, but violates the long-recognized New York rule that any newly added specific material is bound to control. Cardozo, *J.*, speaking for the New York Court of Appeals in *Lieberman* v. *Templar Motor Co.,* 236 N. Y. 139 (1923), stated the rule very clearly:

> "Those who make a contract may unmake it or substitute another either wholly or partly inconsistent. The invalidity of the substituted contract must be determined, like that of any other,

* Italics our own.

> in the light of the situation existing at the hour of its making. If valid then, it will supercede or modify the first to the extent that the two are unable to stand together."

e.

It is settled in New York that any ambiguity or inconsistency in an indenture must be construed against the debtor which prepared the instrument and sold bonds on the basis thereof. Inconsistencies, if any, must be resolved in favor of bondholders purchasing such bonds.[4]

The Court below violated that basic rule by construing what it terms an "inconsistency" against the bondholders (R 213). It thus reads out and nullifies the provisions and evident purpose of Articles III and IV as to due and punctual payment at maturity, as well as Article VI, Section 8, giving bondholders the unconditional right to sue at maturity and instead thereof has given effect to the provisions of Article VI, Section 4, which provide that monies collected by the Trustee, in the exercise of its conditional remedies, shall be paid with interest at the contract rate only on the overdue principal. It holds that any other interpretation would induce an "inconsistency", viz:

> "It would introduce an inconsistency . . . it would result in making it necessary for all bondholders to sue personally, or in a class action, in order to recover the full amount of their claims, and would prevent the Trustee from adequately

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[4] *Prudence Co.* v. *Central Hanover Bank & Trust Co.*, 262 N. Y. 311 affd. 262 N. Y. Supp. 311; *Barnes* v. *U. S. Steel Corp.*, 11 N. Y. Supp. 2d 161; *Cunningham* v. *Pressed Steel Car*, 238 App. Div. 624, 262 (1933) affd. 263 N. Y. 671 (1934); *Enoch* v. *Branden*, 249 N. Y. 263, 268 (1928). See also opinion of District Court herein (R 176, fol. 526).

asserting their rights. Certainly, the Trustee is not to be so crippled; . . ." (R 213).

Further on in the opinion, it denied all other interest on bondholders allowed claim in Chapter X, stating:

> "We find no equities to override the *bargain* which the parties made for themselves, namely, that overdue principal should bear interest at the rate of 5%," (R 217).

But such "bargain" does not exist when the indenture is construed under New York law as we shall see.

In the first place, the ruling below offends the New York law because it effectually wipes out the all important 1933 innovations, for as stated in *Lang* v. *Lutz* (180 N. Y. 254, 259):

> "It was a valuable right, resting on contract and he could not constitutionally be deprived of its full enjoyment. It constituted a part of his security for any debt contracted by the Company."

and in this case the innovation constituted bondholders' sole assurance that at maturity they might immediately reduce any debt to judgment—to the exclusion of any right exercisable by the Trustee in their behalf.*

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* The original indentures vested all rights of action in the Trustee. The 1933 modification restored to bondholders their common law right of suit on the due date. The Circuit Court entirely disregarded this modification and so deprived bondholders of the newly granted right to full freedom of individual action at maturity—a constitutional contract right under New York law. It further contravened local law by depriving bondholders of their constitutional right to have their contractual intent interpreted, and their rights under the contract determined, under applicable New York law.

In the second place, the ruling below actually introduces the very anomalies which the District Court had foreseen and depicted as bound to arise under any interpretation hostile to bondholders under State Law (R 175-176).

Thirdly, under New York law those anomalies are preponderant and of determinant significance in comparison with the "inconsistency" claimed to have been avoided by the Circuit Court, if same ever existed.[5]

Fourthly, under New York law, the 1933 innovation cannot cripple the Trustee nor prevent it from adequately asserting their rights, by any stretch of the imagination.

Construction under local law would assure the preservation and exercise of the paramount rights of bondholders as created in 1933 to reduce their claims to judgment promptly at maturity.[6]

Finally, the sole question in the allowance of interest on allowed claims is whether bondholders have been prevented from reducing their claims to judgment [either by individual or collective action or through a Trustee] or otherwise deprived of the use of their money.[7] If so, interest is allowed on claims from that date, assets being sufficient, and the ruling of the Circuit Court of Appeals on this subject would seem to be entirely beside the point and immaterial to the basic issue.

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[5] See cases footnotes 1 and 4 above.

[6] See cases footnotes 2 and 4 above.

[7] *Johnson* v. *Norris, supra; In re John Osborn Sons, supra; National Bank of the Commonwealth* v. *Mechanics National Bank;* and the state law is parallel.

f.

New York does not confuse "compound interest" with the allowance of simple interest on claims in equity proceedings.*

The local decisions, assets permitting, allow legal interest upon the full face amount of any debt or claim due at the time that creditors are stayed from suit—and that practice is not condemned by the local rule against "compound interest" which arises solely *ex contractu*. The two subjects are entirely separate and distinct (even if the local law be material to the allowance of interest by a Federal Court, which petitioner denies), though both are founded in just and practical considerations.

The Circuit Court of Appeals, in denying interest upon bondholders' claim for the 10 year accumulation of interest, viz; $1,286,646.43 due at maturity, conceived that the allowance of simple interest upon a claim constitutes "compound interest", citing and relying upon *Newburger-Morris Co.* v. *Talcott*, 219 N. Y. 505 (R 217).[8] It not only confused the two subjects but also contravened local law.

In New York claims "are presented when the receiver is appointed and that date fixes their status

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* As indicated above, petitioner does not consider this phase of the local law applicable—but the Circuit below has treated same at length as a controlling consideration herein.

[8] An action *ex contractu* and therefore clearly inapplicable in the allowance of interest upon equitable principles. There interest "compounded monthly" was properly disallowed. The authority on which it is based, *Young* v. *Hill* (67 N. Y. 162, 172, 174), holds the right to compound interest "*depends entirely*" upon contract and carefully points out that:

> "An agreement to pay simple interest upon the several installments of interest as they became due and the payments as made first to the payment of interest until all was paid, might not be unreasonable or inequitable."

and amount" (*People* v. *American Loan and Trust Company*, 172 N. Y. 371);[9] and interest at the contract rate is "credited upon the accounts of the debtor when the receiver takes possession", interest thereafter being allowed at the legal rate upon the whole "indebtedness as established at the time the receiver takes possession" (*People* v. *Merchants Trust Company*, 187 N. Y. 293, 297-99, on authority of *National Bank of the Commonwealth of the City of New York* v. *Mechanics National Bank*, 94 U. S. 437).[10]

The opinion below indicates a cleavage between the equity practice in New York and that in the Federal Courts of equity and bankruptcy. New York parallels the long established Federal equity practice as above shown and in *Hunting* v. *Blun*, 143 N. Y. 511 (1894), it is even held that the existence of an order restraining actions against a debtor are sufficient to give a claimant the status of a judgment creditor. To the same effect see *Lang* v. *Lutz*, 180 N. Y. 254, 260.

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It is essential that the local law be not so misstated by the Federal court.

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[9] Where equities were balanced between creditor and creditor and interest was denied on preferred claims because it would "exhaust the funds in the hands of the receiver and leave nothing for the preferred creditors" thus paralleling the *Vanston* case, *supra*.

[10] Specifically, and in line with the *Mechanics Bank* case, *supra*, it was held in an action against a stockholder that:

> "The creditor's debt consists both of principal and interest. He is just as much entitled to the latter as to the former and the liability to pay the debt must necessarily include the accrued interest up to the statutory limit. When that is reached, any further interest runs only upon that sum from the date of the commencement of the action . . . and the allowance of interest from the maturity of the debt was, therefore proper . . ." (*Wheeler* v. *Miller*, 90 N. Y. 353, 363).

POINT IV.

The unanimous consentient equities in this case rest unequivocally with bondholders.

". . . according to the traditional notions of Anglo-American law, this Court has chosen that rule as to interest which comports best with general notions of equity. *United States* v. *Sanborn*, 135 U. S. 271, 381, 34 L. ed. 112, 115, 10 S. Ct. 812; *Billings* v. *United States*, 232 U. S. 261, 58 L. ed. 596, 34 S. Ct. 421.

"Instead of choosing a rigid rule, the Court has drawn upon those flexible considerations of equity which are established sources for judicial lawmaking.

"Such is this Court's doctrine regarding the imposition of interest in cases where this Court has fashioned its own doctrine."

Jackson County v. *United States*, 308 U. S. 343.

"In the absence of an applicable federal statute it is for the federal courts to determine, according to their own criteria, the appropriate measure of damage, expressed in terms of interest, for nonpayment of the amount found to be due . . .

Here responsibility for delay in payment rests quite as much upon the debtor, who is chargeable with knowledge of its own obligation and the breach of it, as upon the creditor. **And in the meantime the debtor has had the use of the money, of which its default has deprived the creditor.** Interest upon the principal sum from the date of

default, at a fair rate, is therefore an appropriate measure of damage for the delay in payment . . ."

Royal Indemnity Co. v. *United States*, 313 U. S. 289.

Not one single act of this at-all-times-solvent debtor indicates concern for bondholders' rights or respect for its own contractual obligations.

The case does not present one single element or factor offering equitable excuse or justification for the conduct of this debtor in its dealings with its bondholders whose monies represented the greater part of debtor's working capital.

The equitable principles governing allowances of interest under the Bankruptcy Act, should not exempt this debtor from the payment of interest upon the roundly $7,000,000 obligation due bondholders on October 1, 1943.

Debtor's position at the time of filing its petition was one of its own choosing—entirely of its own making. It did not at any time have the excuse of insolvency.

Debtor never evinced any intention whatever of meeting its bonds at maturity, though possessed of assets far in excess of its debts, and able to show a surplus exceeding $2,500,000. During the entire prior 10 year extension debtor deliberately planned to omit such provision.

During the 10 year extension period, it had taken every advantage permitted by the Indenture to annually defer 2% of interest payable to bondholders—and used same to acquire large blocks of its bonds at depressed values [resulting in part no doubt from the decreased rate of 2% annual interest] and at a tremendous profit to itself of about $2,700,000.

On the eve of maturity, by resort to Chapter X, it obtained statutory stay of all actions by or on behalf of its bondholders and relegated them to the status of creditors holding "claims" under the Bankruptcy Act, instead of judgments. This left bondholders powerless to enforce their contractual obligations.

Throughout the 18 months of these proceedings, debtor was able to retain in its business the greater part of $7,000,000 due to bondholders, together with the profits and income therefrom—resisting even by appeal the interim distributions of principal and made no distributions of interest until compelled to do so by order of this Court.

Finding it expedient to refund with the stockholders, as they could always have done, debtor obtained dismissal at the end of some 18 months.

All was carefully planned and premeditated.

The purpose and the effect of debtor's voluntary petition herein was to obtain from bondholders an involuntary extension beyond maturity of their bonds by means of statutory stay, a stay which could never have been contemplated under the provisions of Section 5, Article VI of the 1933 Indenture.

The statutory stay herein gave this solvent debtor, and its co-respondent stockholder, exactly what they wanted, viz, an excuse for detaining the entire debt pending refinancing between themselves or extension by plan if possible. The income from that great sum not only enriched debtor but was a vital part of its estate, its working capital, and a source of great income to it, throughout the period of the stay.

Chapter X was thus resorted to *first;* because debtor had (by its own acts or omission) placed itself in a position where it could not *at the last minute* properly, expediently and economically dispose of assets

sufficient to meet its bonds when they matured; *second,* that debtor might retain among its resources during the proceedings the moneys due bondholders, including the interest deferred during the prior 10 year extension with all income therefrom; *third,* that it might attempt another extension from bondholders by mere partial payment of its obligation of overdue principal and overdue interest; *fourth,* to afford debtor extension and ample time, with all resources still in its possession, to arrange refinancing or refunding with its stockholder if desired; *fifth,* to stay bondholders' enforcement of the bonds without compensation to them [except contract interest on principal only] by asserting the inapplicable provisions of the 1933 Indenture relating to recoveries by the Trustee only.

Having thus obtained all that they desired—by way of deferments of interest, profits through purchase of bonds, deliberate default at maturity and an 18 month involuntary extension of the $7,000,000 obligation—**debtor and its stockholder have now obtained a "free ride" as to $1,286,646.43 and have been relieved of interest at the legal rate on $5,710,400 the face amount of the bonds from the date of maturity.**

Nothing in this case renders it inequitable to grant bondholders compensation for the use of their moneys by way of legal interest upon the lump sum arrears due since October 1, 1945—but every equitable consideration points to the necessity for so doing to properly and legally compensate bondholders for the loss resulting from detention of the whole debt due them at maturity of their bonds.

The equities in the present case are brought clearly into focus when the facts paralleling those in the *Mechanics National Bank* case, *supra,* and *Johnson*

v. *Norris, supra,* are considered. It is then seen that each bondholder was entitled "*ex aequo et bono*" to the amount of his claim as it existed on October 1, 1943 with interest at the legal rate to the date or dates of payment.

In every aspect of this case and from every viewpoint, the equities are unanimous and consentient, and unequivocally rest and "balance" with bondholders.

POINT V.

For the reasons stated in the petition and in this brief, it is respectfully submitted that the writ be granted.

Respectfully submitted,

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